HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

Edmonton CMA

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Canada

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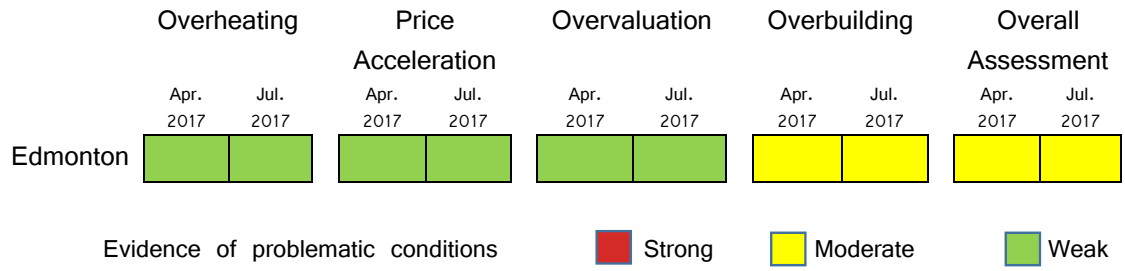
Highlights



- Overall, moderate evidence of problematic conditions[1] continued to be detected in Edmonton's housing market, unchanged from the previous quarter's assessment.
- Moderate evidence of overbuilding was detected as the rental apartment vacancy rate breached its threshold level and the inventory of completed and unsold housing units moved ever closer to its threshold level.
- Evidence of problematic conditions caused by overheating and price acceleration continued to be weak.
- There was only weak evidence of overvaluation as prices have not exceeded their threshold level as determined by economic and demographic fundamentals.
- The Housing Market Assessment (HMA) analytical framework considers four factors to assess the evidence of problematic housing market conditions: overheating; acceleration in the growth of house prices; overvaluation; and, overbuilding. A brief summary of the framework is presented on page 5 of this report.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects problematic market conditions in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolving an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the level of evidence of problematic conditions. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is

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[1] Results are based on data as of the end of March 2017 and local market intelligence up to end of June 2017. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

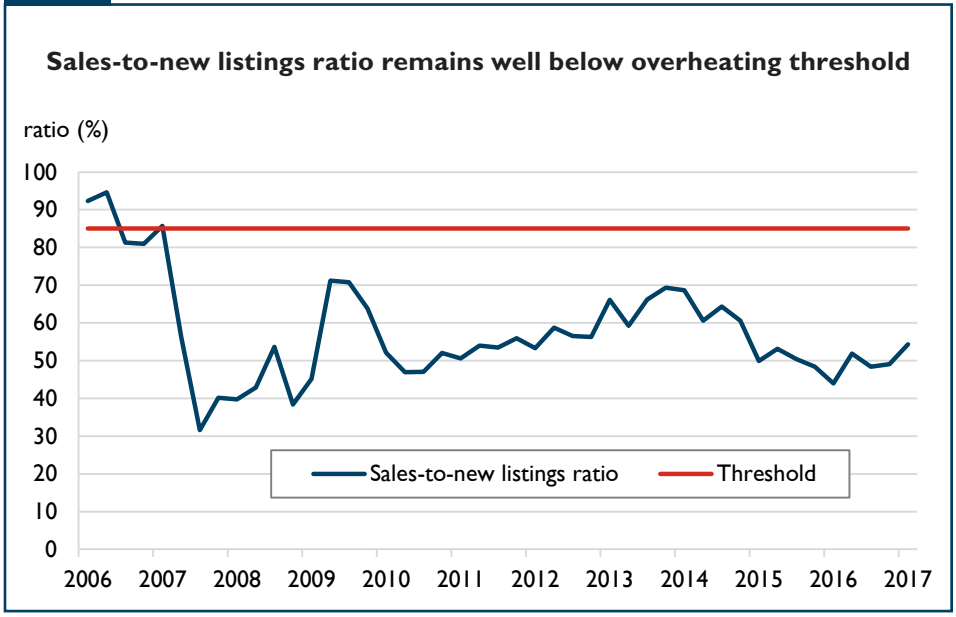
from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

In Detail

Overheating

The Housing Market Assessment (HMA) framework found only weak evidence of overheating in the Edmonton housing market. The sales-to-new listings (SLNR) ratio remained well below its problematic threshold, indicating that demand has not been outpacing supply. The seasonally adjusted sales-to-new listings ratio averaged 54% in the first three months of 2017, up from 49% in the fourth quarter of 2016, but well below the overheating threshold of 85%. Increased sales activity in the existing home market seen in the first quarter of this year has begun to ease with sales slipping in May despite a surge in the number of new listings.

Figure 1

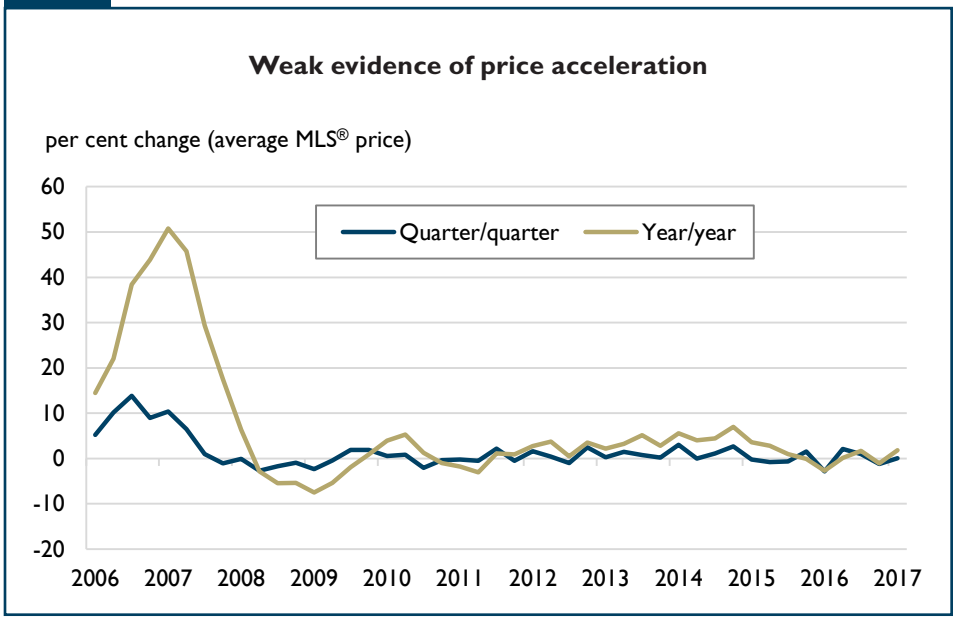


Source: CREA (seasonally adjusted), calculations (threshold) by CMHC
Last data point: 2017Q1

Price Acceleration

Weak evidence of price acceleration continued to be found in the Edmonton housing market. Both the Teranet-National Bank House Price Index™ and the New House Price Index indicate an absence of price

Figure 2

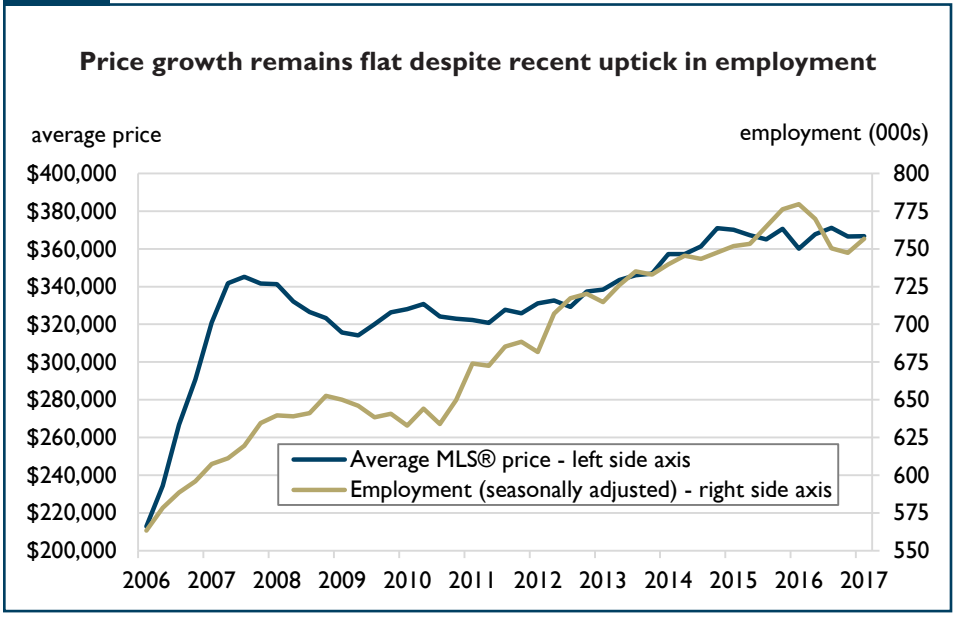


Source: CREA (seasonally adjusted)
Last data point: 2017Q1

"Moderate evidence of overbuilding has been detected for a third consecutive quarter. Additional rental supply pushed the October 2016 vacancy rate above its threshold level while the inventory of completed and unsold homes nearly breached its threshold."

Brent A Weimer
Principal, Market Analysis (Edmonton)
Prairie and Territories Region

Figure 3



Source: CREA (seasonally adjusted), Statistics Canada (seasonally adjusted)
Last data point: 2017Q1

acceleration in the Edmonton market. Similarly, the seasonally adjusted MLS average price in the first quarter of this year was practically unchanged from the last quarter of 2016. Market conditions have been in favour of the buyer since early 2015 resulting in a lack of price growth. Although sales activity picked up somewhat at the beginning of the year, an easing in the May sales-to-new listings ratio suggests that future price growth will remain soft.

Overvaluation

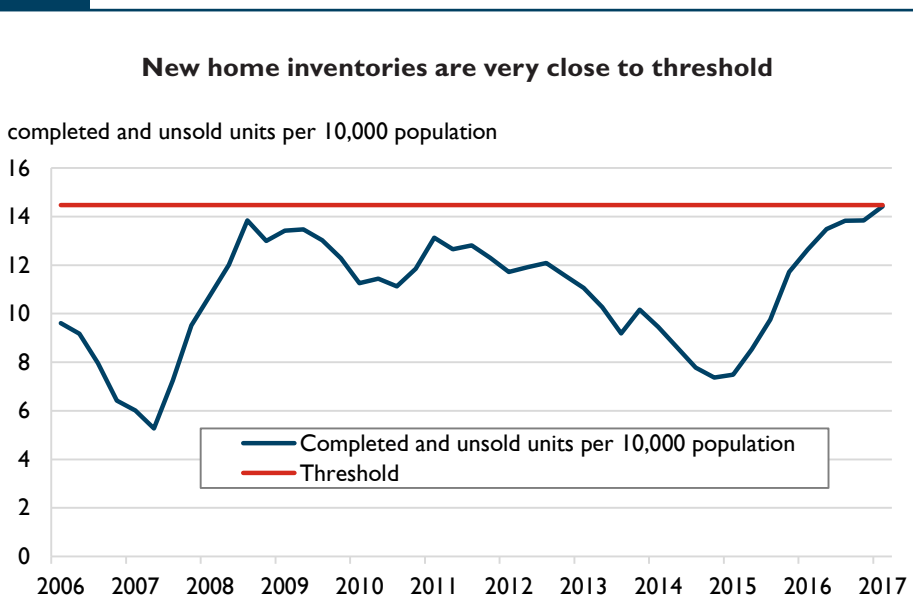
Weak evidence of overvaluation continued to be detected as current price levels remained below their thresholds. Although there has been a lack of movement in home prices, easing demographic fundamentals in the first quarter have lowered their corresponding threshold levels. Particularly noteworthy was the slowing growth rate in the young adult population.

The return of employment growth in the first quarter of 2017 has helped economic fundamentals somewhat. While there has been five consecutive months of employment growth so far this year, a modest pullback in weekly earnings has partially offset these gains. Although average weekly earnings peaked in September 2016, the year-over-year rate of change remained positive until February 2017. Average weekly earnings have continued to trend lower with the year-over-year rate of change in May dipping to -3.6%.

Overbuilding

The assessment for overbuilding continued to indicate moderate evidence of problematic conditions in the Edmonton housing market. At 7.1%, the rental apartment vacancy rate breached its threshold level in 2016 as increasing rental supply outpaced demand. As of October 2016, Edmonton's purpose built rental apartment universe expanded by four per cent compared to the same period of 2015. In the ownership market, the inventory of completed and unsold units moved ever closer to its overbuilding threshold due to an elevated number of row and apartment units. Row and apartment inventories stood at 1,117 units in May compared to 1,120 units at the end of the first quarter.

Figure 4



Source: CMHC, calculations (threshold) by CMHC, Statistics Canada
Last data point: 2017Q1

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to assess housing market conditions.

Specifically, the framework considers four main factors that may provide an early indication of potentially problematic housing market conditions: (1) overheating when demand outpaces supply; (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding when the inventory of available housing units is elevated.

For each factor, the framework tests for: (1) the presence or incidence of signals of potentially problematic conditions, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with weak evidence of problematic conditions. Conversely, as the intensity, number, and/or persistence of the signals increases, the likelihood of a factor becoming problematic increases.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect potentially problematic housing market conditions. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect problematic housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect current problematic conditions relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify problematic overheating conditions, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating conditions on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed.

To assess overbuilding conditions in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the level of evidence of problematic conditions. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of potentially problematic conditions, but also considers the intensity of signals (that is, how far the indicator is from its historical average) and the persistence of signals over time. Generally, low intensity and persistence are associated with a lower potential of upcoming problematic conditions. As the number of persistent signals increases, the evidence of a problematic condition developing increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators signaling significant incidence, intensity and persistence of potentially problematic conditions. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators of a problematic condition from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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